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Dear Tom

Relief from the consequences of Over/Under-Recovery due to the phasing of the DPCR4 losses Incentive Scheme PPL term.

Thank you for your email to Paul Measday dated 23 June requesting further information to facilitate your consideration of our request for the above mentioned relief.

Please find set out below the relevant information by DNO for regulatory years 2013/14 and 2014/15 with additional evidence provided in those cases where we forecast a penalty interest situation arises. This includes the information specifically requested in your email.

Regulatory Year 2013/14

EPN

Table A	Allowed Revenue £m	Recovery £m	Average specified rate	Interest rate adjustment PRT	Interest earned £m
Recovery without interest rate penalty	557.1	-38.5	0.50%	1.50%	0.77
Recovery with interest rate penalty	557.1	-38.5	0.50%	0.00%	0.19
Interest lost					-0.58

At the close of 2013/14 we have calculated EPN to have an under recovery of (£38.5m) or 6.9% of allowed revenue. Of this value, £45m is attributable to the treatment of losses in the tariffs set for 2013/14. Without the losses values we would have ended the year with an over recovery of £6.5m or 1.3%.

Under CRC 14.2 of the DPCR5 license an under-recovery of 6.9% results in the PRT being set to 0% rather than the default 1.5% that would have applied with a recovery position of 1.3%. The setting to zero of the PRT value represents a cost to UK Power Networks of £580k as shown in table A. Accordingly we seek Ofgem's support to grant relief from this adjustment on the basis that the over recovery was the result of issues outside of our control.

We provide the following evidence to support the £45m reduction in revenue incorporated into 2013/14 tariffs:

- In December 2012 we set our 2013/14 tariffs based on the allowed revenue calculation shown in column B1 in table B below. This included a negative £45m PPL component. We had included this value in our tariff setting in response to instructions from Ofgem to include the forecast value from our May 2012 DCUSA Schedule 15 publication (Attachment 1) in our pricing.
- Our expectation was that the DPCR4 losses consultation, when complete, would deliver a PPL term for 2013/14 to match the value included in the prices, we did not therefore forecast any under recovery in the year when pricing. Our expected outcome is shown in Table B, column 2.
- The instruction to include the May 2012 forecast values was made in paragraph 3 of Hannah Nixon's decision letter of 25 July 2012 titled "*Decision on question 9 and 12 of the consultation on whether to activate the losses incentive mechanism in the 5th distribution price control DPCR5*" (Attachment 2).
- In the March 2014 "*Decision on the restatement of 2009-10 data and closing out the DPCR4 losses mechanism*" no PPL term for 2013/14 was set, instead Ofgem decided that any losses component in the 2013/14 prices would be dealt with via the over/under recovery process. Consequently we have included no losses value in our final calculations for 2013/14 as shown in table B column 3 and we now see a large unplanned under-recovery position for 2013/14.

Table B		B1 2013/14 Tariff setting assumptions	B2 2013/14 Provisional revenue return adjusted for anticipated PPL Term	B3 2013/14 Provisional Revenue Return
		£m	£m	£m
Allowed Revenue	Base Revenue	527.8	527.3	527.3
	Expected Losses PPL term	-45.0	-45.0	0.0
	Recovery Brought forward	8.0	6.3	6.3
	Incentive / Pass through	28.4	23.5	23.5
	Total Allowed Revenue	519.2	512.1	557.1
Revenue Collected		519.2	518.5	518.5
Over/Under recovery		0.0	6.5	-38.5
		0.0%	1.3%	-6.9%

LPN

We added £12.0m to LPN 2013/14 tariffs in respect of the expected losses PPL term. However, as can be seen in the table below the 2013/14 recovery position will not attract penalty interest.

Table C		LPN		
		2013/14 Tariff setting assumptions	2013/14 Provisional revenue return adjusted for anticipated PPL Term	2013/14 Provisional Revenue Return
		£m	£m	£m
Allowed Revenue	Base Revenue	444.8	444.8	444.8
	Expected Losses PPL term	12.0	12.0	0.0
	Recovery Brought forward	0.3	1.6	1.6
	Incentive / Pass through	-2.8	-3.6	-3.6
	Total Allowed Revenue	454.3	454.8	442.8
Revenue Collected		454.3	450.9	450.9
Over/Under recovery		0.0 0.0%	-3.9 -0.9%	8.1 1.8%

SPN

We added £1.0m to SPN 2013/14 tariffs in respect of the expected losses PPL term. However, as can be seen in the table below the 2013/14 recovery position will not attract penalty interest.

Table D		SPN		
		2013/14 Tariff setting assumptions	2013/14 Provisional revenue return adjusted for anticipated PPL Term	2013/14 Provisional Revenue Return
		£m	£m	£m
Allowed Revenue	Base Revenue	364.1	364.1	364.1
	Expected Losses PPL term	1.0	1.0	0.0
	Recovery Brought forward	-1.2	-0.6	-0.6
	Incentive / Pass through	15.5	16.9	16.9
	Total Allowed Revenue	379.4	381.4	380.4
Revenue Collected		379.4	376.1	376.1
Over/Under recovery		0.0 0.0%	-5.3 -1.4%	-4.3 -1.1%

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In conclusion, we believe that the details above demonstrate:

- EPN will suffer a penalty interest adjustment for both 2013/14 and 2014/15 under the relevant license conditions.
- LPN and SPN will not suffer penalty interest in either year based on our current forecast assumptions.

I hope the above provides you with the information you require, if you have any queries please do not hesitate to contact me or Paul Measday.

Yours sincerely



Keith Hutton
Head of Regulation

UK Power Networks

Copy Paul Measday, Regulatory Returns & Compliance Manager

Attached

- 1 May 2012 Schedule 15 Forecast
- 2 July 2012 letter from Hannah Nixon
- 3 EPN published Tariff setting models for 2014/15